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BEFORE THE
PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

Docket No. 2003-368-S

DIRECT TESTIMONY OF

RICHARD E. COTTON

FOR THE

CITY OF CLEMSON

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UTILITIES DEPARTMENT

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Richard E. Cotton. I am currently the City Administrator of the City of Clemson and have served in this position since January 1, 1996. My business address is Post Office Box 1566, Clemson, South Carolina 29633-1566.

Q. WHAT IS YOUR EXPERIENCE WITH UTILITY ISSUES IN GENERAL AND WITH THIS RATE CASE SPECIFICALLY?

A: Prior to my appointment in Clemson, I served for nearly eight years as City Manager of Winfield, Kansas, and four years as City Manager of Belleville, Kansas. I served as the Assistant to the City Manager of Emporia, Kansas from 1982 to 1984, and was an Administrative Intern for the City of Merriam, Kansas, in 1982 and 1983. During the past 22 years, I have been responsible for multiple utility operations, including water treatment, water distribution, wastewater collection and treatment, electric utility

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(generation, transmission, and retail to other cities), natural gas distribution, commercial and residential sanitation, and recycling.

I also am a resident of the Heatherwood subdivision and Madera is the wastewater utility company that serves my home. I became aware of the proposed Heatherwood lagoon closure within the first two months as City Administrator of Clemson. During the past eight years, I have met with representatives of DHEC on multiple occasions about the Heatherwood lagoon, spoken with Mr. Jack Rogers, a Madera Utilities officer, completed two separate engineering studies on issues related to the lagoon closure costs and options, and reviewed the potential costs related to the City of Clemson's possible acceptance of the responsibility for operation of the Madera system.

Q. HOW WOULD YOU ASSESS YOUR EXPERTISE IN UTILITY OPERATIONS?

A. I have a bachelor's degree in business administration and I earned a Master of Public Administration, for which I studied utility operations, rate administration, and policy and operational issues. I have presented annual operating budgets for a wastewater utility for the past 20 years. My experience and education have provided me with a good understanding of wastewater utility operations, rates, budget preparation, and regulatory issues.

Q. WHEN DID YOU FIRST BEGIN TO CONSIDER THE ISSUES RELATED TO THE HEATHERWOOD LAGOON AND MADERA UTILITIES?

A. The first evaluation of the Heatherwood lagoon was an engineering study completed by B.P. Barber Engineers in 1996. City staff also evaluated the potential impact on our Pendleton/Clemson wastewater treatment plant capacity should the effluent from the Madera system be diverted to the City's system in the future.

Q. WHAT DID THE SECTION 201 WASTEWATER FACILITIES PLAN FOR PICKENS COUNTY, PUBLISHED IN 1993, SAY ABOUT THE POTENTIAL CLOSURE OF THE HEATHERWOOD LAGOON?

- A.** The 201 Plan was one of the first items that I researched in review of the issues concerning the Heatherwood lagoon. Two important issues are included in that document: first, the Heatherwood lagoon was scheduled for closure at some time in the future; and, secondly, the collection system that feeds the lagoon has a serious problem with inflow and infiltration. A 1.9 inch rain event resulted in a daily inflow of 205,300 gallons per day in 1992.

Upon review of the 201 Plan, the most reasonable response from Madera's management should have been to consider the question "When will this lagoon be closed and how much will it cost to divert the effluent to another utility system for wastewater treatment." That inquiry should have triggered an immediate review of the Company's rate structure and financial condition to ensure that adequate capital would be available for connecting to another utility system. If the company's income statement did not show sufficient revenue to contribute to a "capital reserve account," then immediate action should have been taken to adjust the rates to create an income stream to accumulate sufficient cash reserves to provide for the eventuality of the capital project. That action would have ensured that rate adjustments in the future would not create "rate shock" for the customers of the utility.

Secondly, the 201 Plan should have adopted the company to the serious inflow and infiltration problem with the collection system. There are two alternatives to deal with that problem. First, as a utility operator, I know that I will pay for the inflow and infiltration problem through a financial contribution to the treatment plant owner, because

the inflow problem will cause the need for additional capacity at that treatment plant. The second alternative would be to reduce the inflow into my collection system, so that the sewer system is collecting only wastewater effluent – which I will pay to be treated at someone else's treatment plant. Unfortunately, the company took no action then, or since – until now, eleven years after the publication of the 201 Plan to change rates or plan for the future of this utility system.

Q. WHAT DISCUSSIONS HAVE BEEN CONDUCTED TO INCREASE AWARENESS OF THESE PROBLEMS AND THE NEED FOR ACTION?

Two public meetings were conducted on May 24 and August 23, 1990, to discuss the future wastewater needs of the 18 Mile Creek Basin. These meetings were preliminary to preparation of the 201 Plan. As a utility operator in this Basin, Madera was invited to participate in the meetings. The company had the opportunity to attend and comment during these and other meetings during the nearly three year planning period leading up to publication of the 201 Plan. At the end of the Section 201 process, additional public meetings were held on April 23 and November 4, 2003, at which time recommendations were presented for dealing with the problems. Therefore, throughout that lengthy process, Madera has had full knowledge of the operational conditions and their financial repercussions that would be occurring in future years.

Q. WHAT ACTION HAS DHEC TAKEN WITH RESPECT TO THE HEATHERWOOD LAGOON?

A. After the publication of the 201 Plan, DHEC initiated an administrative action which resulted in DHEC's order to close the lagoon and to divert the wastewater from the customers presently served by the collection system and lagoon to the treatment and disposal facilities of either the City or Pickens County. Madera has contested DHEC's decision in an appeal that has been pending for many months in the Court of Common Pleas for Richland County.

Q. HAS THE CITY CONSIDERED THE ISSUES RELATED TO THE DIVERSION OF MADERA'S WASTEWATER EFFLUENT INTO THE CITY'S UTILITY SYSTEM?

A. Yes. The City met with Mr. Jack Rogers to discuss the possibility for Madera's connection to our collection system. Additionally, we shared with Madera the results of the B.P. Barber Engineering study. We also discussed the potential for the City to take over the ownership of the collection system, but only after Madera would make the necessary investment to connect to the City's system. Additionally, I met with Mr. Rogers at the DHEC offices in Columbia to visit with Mr. Robin Foy, DHEC's representative about the Heatherwood lagoon, DHEC's order, and timing of the closure.

The Clemson City Council has also discussed this issue on multiple occasions. It has been Council's position that the City of Clemson should not be considered as a "bail out option" for Madera. The City Council would consider taking over the collection system, but Madera should be responsible for paying the costs related to connecting to the City's system. If Madera would accept the responsibility for payment of the costs of connection, the City Council would likely agree to accept the collection system and divert the wastewater. The City would not pay for the actual closure of the lagoon system because that is a responsibility of the lagoon's owners.

Q. DID THE CITY RECOGNIZE THAT THERE WOULD BE A POTENTIAL IMPACT ON THE 114 HOUSEHOLDS THAT ARE SERVED BY MADERA? IF SO, WHAT WAS YOUR RESPONSE AND ACTIONS IN COMMUNICATING THIS TO THE CITY RESIDENTS?

- A. Yes. The City knew that the residents were in an unfavorable position. Not only had the City received reports and comments about the poor quality of Madera's services, but we were also aware that Madera had not performed proper maintenance on the system, which has resulted in problems that would have to be corrected at some point in the future.

In the spring and summer of 2002, the City of Clemson initiated a series of meetings with affected residents, to inform them about DHEC's order and eventual closure of the lagoon. We informed the residents that the City Council was willing to accept the collection system from Madera, which would result in the City of Clemson becoming their wastewater utility service provider. However, we also informed the residents of the problems (inflow and infiltration of ground water) with the collection system.

The City Council also indicated that the existing users of the City's system should not be responsible to cover the costs of repairing the Madera collection lines, and that the Heatherwood and Eastbriar residents would be required to pay a "surcharge" of approximately \$1.00 per 1,000 gallons of water consumed for a period of eight to ten years. That would allow the persons using the system and benefiting from the upgrades to pay the costs of correcting the collection system problems, while not placing an additional burden on the other users of the City's system. Our philosophy was, "The City did not create these problems, so our existing ratepayers will not bear the costs of bailing out Madera's failure to plan and maintenance deficiencies." Likewise, the City did not force this issue on the affected residents. We informed them that an alternative wastewater treatment plant was available, and Madera could arrange for the wastewater effluent to be treated at Pickens County's new Middle Basin Treatment Plant. However, the current rates of Pickens County are already \$1.00 per 1,000 gallons more expensive than the rates of the City of Clemson. Council agreed that the impacted residents could

have their own “vote” to determine if they wanted the City of Clemson to be their future wastewater service provider – with the provision that an additional surcharge would be calculated into their rates. The City provided a “ballot” and allowed the residents to respond to Council’s position. The response was overwhelmingly positive to have the City become the new wastewater provider, if possible.

In addition to the cost and rate issues at these public meetings, Mr. Robin Foy or a representative of DHEC attended two of the three meetings. They discussed the issues in DHEC’s order and answered questions posed by the affected residents. The residents expressed their frustration with the situation and their concern for the possible future costs of their sewer service.

Q. WHY DO YOU BELIEVE THAT THE COMMISSION SHOULD NOT GRANT THE PROPOSED INCREASE THAT MADERA HAS REQUESTED?

A. Madera Utilities has not operated in a manner consistent with good utility practices during my entire tenure in Clemson. The Company has not taken care of the collection system, conducted preventive or annual system maintenance on the lines, been good financial stewards, or demonstrated concern for the interests of its customers. Its management has had knowledge of the closure of the Heatherwood lagoon since before 1993, and it has not adjusted the rates to prepare for this eventuality. In its Application, Madera admits that it not requested rate increases, but offers no legitimate excuse for their management decision. It is hard to escape the conclusion that Madera has spent more time and money in fighting DHEC’s Order than it has in managing its utility operations properly.

Q. WHAT TECHNICAL DEFICIENCIES HAVE YOU NOTED ON THE PRO-FORMA STATEMENT IN MADERA’S APPLICATION?

A. The most significant issue is Madera's basic understanding of its future costs of operations. Other than the "mortgage payment" that the company proposes to pay for costs of diverting the effluent and "improving an aging system," it has not identified the treatment costs. The company inflated estimates of repairs and maintenance, professional fees, management fees, attorney's fees and bill collection fees, but fails to take into consideration the largest cost of its small utility – the wastewater treatment fee. Once the lagoon operations cease and the improvements are completed, chemicals, repairs, lab costs, and many other costs will cease to exist. These application should reflect a minimal cost or zero cost. However, the company should count on paying a treatment fee to Pickens County or the City of Clemson – who will be treating the diverted effluent. That fee will be somewhere between \$3.13 and \$4.50 per 1,000 gallons of effluent that is diverted into the City or County's system. The total flow volume will be approximately 7.5 million gallons of actual water consumption plus an inflow/infiltration factor. This cost is not reflected on the company's pro-forma statement (Exhibit C). The very fact that this cost does not appear as a line item demonstrates the questionable quality of the planning and operational management.

Q. HAVE YOU SEEN ANY ENGINEERING WORK THAT HAS BEEN PREPARED AT THE DIRECTION OF MADERA? DO YOU KNOW WHERE MADERA'S CONSTRUCTION ESTIMATES HAVE ORIGINATED?

A. I have not seen any engineering work product that has been independently prepared by Madera Utilities or its engineering firm(s). The cost to divert the effluent line of \$134,000 is the cost of one of the alternatives from the B.P. Barber Engineers report, dated December 2002. Likewise, their collection system repair estimate of \$180,000 was from the same report. They have had an engineer visit with the City's utility

personnel, but I would assume that those brief discussions are the only engineering work that has been conducted for the Heatherwood system.

Q. WHAT DO YOU BELIEVE THE COSTS OF DIVERTING THE WASTEWATER TO THE CITY OR PICKENS COUNTY COLLECTION LINES WILL BE?

A. The cost of diverting the wastewater is likely very close to the estimate in the B. P. Barber report in December 2002. However, if the City of Clemson were to accept the future responsibility of this system, we would likely design the line to avoid the installation of a sewer lift pump station. The City is presently considering the construction of a line that would allow the Heatherwood lagoon to gravity feed to the City's new line. This line is not planned for construction for several months in the future, but the training could be accelerated to accommodate the connection to the Madera system. This will not save Madera any capital investment, but would save their cost of operating a lift station in future years.

Q. WHAT DO YOU BELIEVE WILL BE THE COST OF REPAIRING THE COLLECTION LINES ON THE MADERA COLLECTION SYSTEM?

A. The collection system report is significantly overstated. The cost of \$180,000 had an assumption that the entire collection would have to be replaced, which is not necessary. Without having permission to run our sewer television camera through Madera's lines, we have no way of determining the actual repair costs. We do know that some of the line is newer and will not need to be completely replaced. The City feels that the "true cost" of fixing Madera's lines will be somewhere between \$80,000 and \$120,000, but this is an "educated guess" that uses sewer maps, age of lines in the subdivisions, and current line replacement costs of our utility. The actual cost of repairing these lines cannot be

effectively determined until the lines are visually inspected and the extent of replacement measured.

Q. DO YOU BELIEVE THAT MADERA SHOULD BE ALLOWED TO SET THEIR RATES WITH THE ESTIMATES THAT HAVE BEEN PREPARED BY THE CITY OF CLEMSON?

A. No. The City Council does not authorize expenditures on capital improvement projects until the engineer's estimate is firm. Madera has not taken the time or effort to have its lines visually inspected. The Company could not know the condition of these lines, and, therefore, cannot accurately determine the replacement costs. Again, this lack of management planning and preventive maintenance scheduling is an indication of poor quality of service and adds to the reasons that demonstrate that this rate request is without merit. Madera has a responsibility to its customers to ensure that a true estimate and condition of line inspection has been completed – prior to asking those customers to pay any costs of improvements.

Q. WHAT AMOUNT SHOULD BE INCLUDED IN REVENUE REQUIREMENTS FOR MADERA'S PROPOSED IMPROVEMENTS?

A. None. Madera's management has known for the past eleven years that effluent from its system would be diverted to another utility. They have had the same amount of time to create a capital reserve account, but they have not set aside any revenues to plan for this certainty. The stockholders of the company are properly responsible for making these investments. Then, after the work has been completed and costs verified, Madera could apply to the Public Service Commission to include the costs in its revenue requirements for rate-making purposes. In addition, Madera should be required to amortize the costs of

its improvements over the life of the assets. Why should the company be allowed to recover its investment of a 25 year improvement over the term of a 15-year “mortgage?”

Q. WHAT ARE THE OTHER PROBLEMS WITH THE PROPOSED MADERA RATE STRUCTURE?

A. Madera is treating each household as equal in its rate request. However, why should a single, elderly person that uses only 1,500 gallons of water per month pay the same amount as a family of six persons? Apparently, Madera does not consider the basic issue of equity in rates to be important. However, in my opinion, it is unreasonable to set rates that are not equitable and based on a flat fee – unless the fee is small enough to be “reasonable” for all residents to pay. A fee of \$893 per year for sewer service is not reasonable for a household that consumes average or minimal water consumption.

Q. WHY DO YOU SAY THAT IT IS UNREASONABLE? COMPARED TO WHAT?

A. A household in the City of Clemson utility system that uses 5,000 gallons of water per month will pay \$25 per month (\$300 annually). The Madera proposed rate is nearly three times that amount. In my opinion, a rate of \$893 per year will negatively impact the disposable income of the household, will make the resale value of the property decline, and is not a fair rate for the quality of service that is received. The residents of these neighborhoods are being asked to pay excessively for the poor management of the utility. The stockholders of Madera should not be rewarded for failing to hold management accountable.

Q. IS THE CITY INTERESTED IN TAKING OVER THE MADERA WASTE-WATER COLLECTION SYSTEM?

- A. Yes. The City of Clemson would be interested in taking responsibility for the collection system, but not in the form of a “bail out” of Madera. In our opinion, Madera has failed to plan properly for the certainty of the lagoon closure and diversion of effluent to another system. We have known for the past 12 years that this lagoon system would be closed and the effluent diverted. If Madera had increased its rates in 1992, to generate \$10,000 per year – which would have represented less than a 50% rate increase or \$8 per month for a residential household – it could have reserved the amount \$120,000 for diverting the flow. Simply stated, we do not believe that a failure on Madera’s part to plan for the future can justify an emergency rate increase of 325%. Madera has the option to sell additional stock to raise capital for the lagoon closure. Instead, the company opted to request the Commission to approve an unreasonably excessive rate increase. It seems that Madera’s traditional response to any problem has been – delay, delay, delay, and hope that someone will bail the corporation out of any potential financial loss.

The City of Clemson would be the best operator of this wastewater collection system and would make the improvements to the collection lines. The homeowners have already “voted” to accept a surcharge on their wastewater rates for the next 8 to 10 years. The service level and response time for emergencies would be dramatically improved with our wastewater service for the Heatherwood lagoon customers. The Commission would not have to deal with the problems of this utility in future years. The customers would be assured that the replacement work would be completed to the City’s construction specifications. And, the list could go on and on. It simply makes sense for the City of Clemson to take over this wastewater system. However, it also makes sense that Madera should be required to pay the costs of meeting the requirements of the DHEC order that it has been challenging for the past many months.

Q. WHY DO YOU BELIEVE THAT MADERA SHOULD BE REQUIRED TO PAY FOR SOME BASIC COSTS OF IMPROVEMENT PRIOR TO THE CITY OF CLEMSON'S TAKING OVER THE SYSTEM?

A. This situation resembles the recent Carolina Investors Investment Firm collapse, in that poor financial planning and mismanagement of company assets will cause the average household to “take a financial licking” to bail out the officers of the company. Since 1993, Madera has known that closure of the lagoon was a reality. Madera had 12 years to plan for this event; Madera has sold other utility operations in South Carolina, Madera has not applied to the Commission for rate increases to address the need for reasonable revenue adjustments; and Madera has not experienced a financial loss to their officers or stockholders to this point in time. Why should the proverbial “little guy” get financially “wholloped” for the failure of the officers of a company to manage the business using good utility practices? In the same vein, why should the City of Clemson and the residents of Eastbriar and Heatherwood have to cover the cost of diverting this wastewater flow? There is no legitimate reason that this unreasonably excessive rate increase application should have ever been filed. It is simply the result of a lack of planning and poor management oversight.

Q. AS A UTILITY PROFESSIONAL AND A RESIDENT OF THE HEATHERWOOD NEIGHBORHOOD, WHAT DO YOU BELIEVE SHOULD BE THE RESPONSE OF THE PUBLIC SERVICE COMMISSION TO THE APPLICATION IN THIS CASE?

A. My parents used an old saying when I was growing up. It was, “If you make a mess in your own nest – don’t expect someone else to come and clean it up. You can fix it yourself or learn to live with the consequences.” Madera has known of this situation for

years and failed to deal with it. It should not expect someone else to clean it up. The Commission should deny the rate request. If this means that they will take a financial loss, Madera will have to determine how it will meet this loss. The company should not expect the homeowners of Eastbriar and Heatherwood to reward them for their past poor financial and operational performance.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.